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In the Supreme Court of the United States

OCTOBER TERM, 1989

COMMONWEALTH OF PENNSYLVANIA, DEPARTMENT OF PUBLIC WELFARE, ET AL., PETITIONERS

v.

EDWARD J. AND DEBORA A. DAVENPORT

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONERS

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QUESTION PRESENTED

Whether an obligation to pay restitution imposed as part of a criminal sentence is a "debt" within the meaning of the Bankruptcy Code, 11 U.S.C. 101(11), and is therefore dischargeable under Chapter 13 of the Code.

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INTEREST OF THE UNITED STATES

This case presents the question whether an obligation to pay restitution imposed as part of a criminal sentence constitutes a "debt" for purposes of the Bankruptcy Code—and is therefore dischargeable under Chapter 13 of the Code. Orders to pay restitution are frequently included in federal criminal sentences. Under the Victim and Witness Protection Act of 1982, Pub. L. No. 97-291, § 5, 96 Stat. 1253-1255, and the Sentencing Reform Act of 1984, a federal sentencing court must consider, among other factors, "the need to provide restitution to any victims of the offense." 18 U.S.C. 3553(a)(7). Moreover, if the court decides to order less than complete restitution, it must include a statement of its reasons. 18 U.S.C. 3553(c). The United States is empowered to collect restitution imposed

in criminal proceedings. 18 U.S.C. 3663(h). The decision in this case could affect the enforceability of sanctions that Congress has directed federal courts to impose for violations of federal criminal law.

In addition, agencies of the United States that have been victimized by crimes are frequently the beneficiaries of restitution orders. For example, sentences imposed on individuals whose criminal acts have imposed losses on federally insured banks and thrift institutions have often required defendants to make restitution to the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation (which has now been consolidated into the FDIC).[1] In many cases, the defendants are white-collar defendants who, though insolvent at the conclusion of their criminal proceedings, have prospects for substantial future income. In order to preserve the deterrent, rehabilitative, and compensatory purposes of restitution orders, the FDIC and similarly situated federal agencies have a strong interest in assuring that defendants against whom such orders are imposed cannot employ bankruptcy proceedings to avoid serving their sentences.

STATEMENT

1. Many individual debtors have a choice among several forms of bankruptcy, two of which are relevant to this case. Under Chapter 7, a trustee in bankruptcy takes possession of the debtor's estate, 11 U.S.C. 541, and pays claims against the debtor in the order of their priority, 11 U.S.C. 726. The debtor is discharged from all debts that

[1] As of June 30, 1988, there were an estimated 7,350 open FBI and grand jury investigations involving fraud and misconduct against banking institutions. H.R. Rep. No. 1088, 100th Cong., 2d Sess. 10 (1988).

arose prior to the filing of the bankruptcy petition, 11 U.S.C. 727, with the exception of ten enumerated categories, 11 U.S.C. 523(a). One of those exceptions covers any debt (11 U.S.C. 523(a)(7))

> to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss * * *.

Under Chapter 13, debtors who have regular income and whose secured and unsecured debts do not exceed $350,000 and $100,000 respectively, 11 U.S.C. 109(e), may file a plan under which they undertake to make regular payments to their creditors from future income, 11 U.S.C. 1322. Except as otherwise provided by a plan, debtors in Chapter 13 retain possession of their assets, 11 U.S.C. 1306(b). If and when they complete payments due under their plan, Chapter 13 debtors receive a discharge of all debts except for alimony and child support and certain long-term debts. 11 U.S.C. 1328(a); see 11 U.S.C. 523(a)(5), 1322(b)(5).

Under either Chapter 7 or Chapter 13, a discharge releases only those obligations that fall within the Code's definition of "debt." Section 101(11) provides that " 'debt' means liability on a claim." The term "claim" is defined as a (11 U.S.C. 101(4))

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured[.]

A "creditor" is a person who has a "claim" against the debtor. The interpretation of these related definitions determines not only the scope of a discharge in bankruptcy, but also the applicability of many of the Code's other provisions.

2. In *Kelly* v. *Robinson*, 479 U.S. 36 (1986), this Court discussed, but did not finally resolve, the question whether a criminal sentence requiring a defendant to pay restitution creates a "debt" subject to the Bankruptcy Code. In *Kelly*, an individual had been ordered, as a condition of probation, to repay amounts she had obtained through welfare fraud. After receiving a discharge under Chapter 7, she sought a determination that the restitution obligation constituted a "debt" within the scope of the discharge. This Court found that Congress had "enacted the [Bankruptcy] Code in 1978 against the background of an established judicial exception to discharge for criminal sentences, including restitution orders," *id.* at 46, and that "...e basis for this judicial exception [was] a deep conviction that federal bankruptcy courts should not invalidate the results of state criminal proceedings," *id.* at 47. Accordingly, the Court expressed "serious doubts whether Congress intended to make criminal penalties 'debts' within the meaning of § 101(4)." *Id.* at 50. The Court found it unnecessary, however, to resolve that question, since it concluded that Section 523(a)(7) preserved the debtor's obligation to pay restitution, even if the obligation was considered a debt under the Code.

3. This case involves debtors who received a discharge under Chapter 13, specifically Section 1328(a). Section 523(a)(7)—the provision at issue in the Chapter 7 proceedings in *Kelly*—is inapplicable here. The case thus presents the question the Court reserved in *Kelly*.

a. In 1985, after pleading guilty to welfare fraud in state criminal proceedings, respondents Edward and

Debora Davenport were each sentenced to one year of probation, and were ordered to pay $208 per month in restitution until they had paid a total of $2,072.40. Payments were to be made to petitioner Bucks County, Pennsylvania, Probation Department, which in turn was to forward the payments to petitioner Pennsylvania Department of Public Welfare, the victim of the welfare fraud. Pet. App. 5a.

In May 1987, respondents filed a voluntary petition under Chapter 13 of the Bankruptcy Code. They listed the restitution obligation among their unsecured debts; under their plan, that obligation and their unsecured debts were to receive equal treatment. The bankruptcy court approved the plan, and respondents completed their payments under the plan in about a year. In July 1988, respondents received a discharge under 11 U.S.C. 1328(a). Pet. App. 5a-8a.

In the meantime, when respondents failed to make scheduled restitution payments in accordance with their criminal sentences, the Bucks County Probation Department commenced violation of probation proceedings. In response, respondents initiated an adversary proceeding in the bankruptcy court in which they sought a declaration that their restitution obligation was dischargeable. Pet. App. 6a. The bankruptcy court held that the restitution obligation was a "debt" dischargeable under Chapter 13. *Id.* at 68a-104a. On appeal, the district court reversed; it found the reasoning of *Kelly* v. *Robinson*, *supra*, controlling on that question. Pet. App. 59a-66a.

b. A divided panel of the court of appeals reversed, holding that the restitution obligation had been discharged. Pet. App. 1a-58a.[2] The majority noted that most

[2] In the court of appeals, respondents' appeal was consolidated with two other appeals presenting the same question. The court found,

pertinent bankruptcy court decisions had concluded that restitution obligations were not "debts" within the meaning of the Code, and acknowledged that "facially there is considerable merit to [the] arguments" on which those decisions were based. *Id.* at 17a, 19a. Nevertheless, the majority felt "constrained to disagree with the ultimate conclusion that the restitution obligation is not a debt under the Code." *Id.* at 19a.

Beginning with the statutory language, the majority rejected the State's contention that a criminal restitution order does not create a "debt" because it is not enforceable by the victim. Pet. App. 19a-26a. The majority concluded "that because the debtors here have incurred a very real obligation to which the Probation Department holds a right to payment within the meaning of section 101(4) of the Code, that obligation constitutes a 'debt' under the Code." *Id.* at 26a. The State's interpretation, the majority added, would lead to the "anomalous" or "incredible" result that the victim could not participate in payments under a debtor's Chapter 13 plan. *Id.* at 23a, 26a.

Neither of the concerns on which this Court had relied in *Kelly*, the majority continued, "alter[ed] the conclusion that a restitution obligation is a debt." Pet. App. 27a. Noting that in *Kelly* this Court had held that Section 523(a)(7) codified those concerns, the majority reasoned that "Congress must have recognized that such obligations were debts within the meaning of the Code." Pet. App. 29a. The majority stated that Section 523(a)(7) "logically leads to the conclusion not only that criminal restitution orders are debts under the Code but also that such penalties are debts despite the underlying motivations of

however, that the question was not ripe for review in the other cases, since the debtors had neither completed their plans nor, for that reason, received a discharge under Section 1328(a). Pet. App. 12a-13a.

punishment and rehabilitation." Pet. App. 30a; see also *id.* at 35a-36a.

The majority found further support for its conclusion in "Congress' objective of encouraging debtors to select the repayment option available under Chapter 13." Pet. App. 31a. If restitution obligations were not part of a Chapter 13 plan, the majority explained, then creditors would be reluctant to approve it, making Chapter 13 entirely unavailable to some debtors – a result "contrary to Congress' objective of expanding the availability of the Chapter 13 option." *Id.* at 33a.

Finally, the majority declined to recognize an implied exception for criminal sanctions to a Chapter 13 discharge. The majority explained that Congress "has codified the criminal penalties exception to discharge and has chosen not to apply the exception to Chapter 13 bankrupte[ies]." Pet. App. 40a.

Judge Hutchinson dissented. Relying on *Kelly*'s reasoning, he would have found that the history of noninterference with criminal judgments in bankruptcy proceedings and the policy against federal intrusion on state criminal proceedings required the conclusion that criminal penalties were not "debts" within the meaning of the Bankruptcy Code. Pet. App. 43a-58a.[1]

[1] As the court of appeals noted, the courts have divided, both before and after *Kelly*, on the issue whether criminal penalties – including restitution orders – are "debts" within the meaning of the Bankruptcy Code. Compare *In re Norman*, 95 Bankr. 771 (Bankr. D. Colo. 1989); *In re Ferris*, 93 Bankr. 729 (Bankr. D. Colo. 1988); *In re Kohr*, 82 Bankr. 706, 709-712 (Bankr. M.D. Pa. 1988); *In re Oslager*, 46 Bankr. 58 (Bankr. M.D. Pa. 1985); *In re Vik*, 45 Bankr. 64, 66-68 (Bankr. N.D. Iowa 1984); *In re Pellegrino*, 42 Bankr. 129, 132-135 (Bankr. D. Conn. 1984); *In re Jacobson*, 35 Bankr. 40 (Bankr. D. Ariz. 1983); *In re Johnson*, 32 Bankr. 614 (Bankr. D. Colo. 1983); *In re Magnuson*, 21 Bankr. 800 (Bankr. D. Ariz. 1982); *In re Button*, 8 Bankr. 692 (Bankr. W.D.N.Y. 1981), with *In re Robinson*, 776 F.2d

SUMMARY OF ARGUMENT

In *Kelly* v. *Robinson*, *supra*, the Court stopped short of holding that an obligation to pay restitution imposed as part of a criminal sentence is not a "debt" within the meaning of the Bankruptcy Code. The principles of statutory interpretation on which the Court relied in *Kelly* now justify that step.

A. Viewed as a whole, the Bankruptcy Code strongly suggests that Congress did not intend for state and federal criminal penalties to be administered within the bankruptcy system. The Code exempts from the automatic stay the "commencement or continuation of a criminal action against the debtor." 11 U.S.C. 362(b)(1). This provision, designed to prevent criminal offenders from using bankruptcy as a haven, permits state and federal authorities to take a variety of steps to collect criminal monetary penalties while bankruptcy proceedings are pending. In the face of this clear indication that Congress intended criminal proceedings to go forward without interference from bankruptcy courts, treating criminal penalties as "debts" would have a number of anomalous consequences. The Code could be construed to treat criminal fines or restitution paid on the eve of bankruptcy as preferential

30 (2d Cir. 1985), rev'd on other grounds, 479 U.S. 36 (1986); *In re Hecmy*, 78 Bankr. 246 (Bankr. 9th Cir. 1987), rev'd on other grounds, 858 F.2d 548 (9th Cir. 1988); *Price* v. *Multnomah County District Attorney's Office Victim Assistance Programs*, C.V. No. 89-307-PA (D. Ore. June 14, 1989), appeal pending, No. 89-35482 (9th Cir.); *In re Cancel*, 85 Bankr. 677 (N.D.N.Y. 1988); *In re Wisconsin Barge Lines, Inc.*, 91 Bankr. 65, 67-68 (Bankr. E.D. Mo. 1988); *In re Hackney*, 83 Bankr. 20, 23 (Bankr. N.D. Cal. 1988); *In re Colliens*, 77 Bankr. 825 (Bankr. D. Colo. 1987); *In re Gilliam*, 67 Bankr. 83, 85-87 (Bankr. M.D. Tenn. 1986); *In re Vandrover*, 61 Bankr. 191, 194-196 (Bankr. D.N.D. 1986); *In re Brown*, 39 Bankr. 820, 821-826 (Bankr. M.D. Tenn. 1984); *In re Young*, 10 Bankr. 17 (Bankr. S.D. Cal. 1980).

transfers avoidable by the bankruptcy trustee. 11 U.S.C. 547. Criminal judgments would be assigned a priority near the bottom of all claims that may be satisfied from the debtor's estate, behind even late-filed unsecured claims, and ahead of only post-petition interest and the debtor himself. 11 U.S.C. 726(a). Liens to secure criminal penalties that States and the federal government are expressly permitted to create and enforce under Section 362 would be invalidated under Section 724(a). And criminal sentences would be discharged for some categories of corporate and individual debtors, but not for others. See 11 U.S.C. 523, 727, 1141(d), 1328(a). Those anomalies cannot fairly be attributed to Congress, and they would be eliminated entirely if criminal penalties were excluded from the definition of "debt."

B. Removing criminal penalties from the bankruptcy system would also carry forward the approach to those obligations that prevailed prior to the Bankruptcy Code's enactment. As the Court noted in *Kelly*, 479 U.S. at 46, there existed "an established judicial exception to discharge for criminal sentences, including restitution orders." In other respects as well, the results flowing from excluding criminal penalties from the definition of "debt" would conform to the handling of those obligations under pre-Code law. Congress should not lightly be deemed to have departed from that traditional approach; moreover, in view of this long history, it would by no means be "anomalous" or "incredible," as the court of appeals suggested, to exclude criminal penalties from the bankruptcy scheme.

C. Interpreting the Code's definition of "debt" to include criminal penalties would also foster federal interference with state criminal proceedings. Experience with that construction of the Code demonstrates that it leads inevitably to orders invalidating criminal sentences

and restraining state authorities and courts. That interpretation thus flies in the teeth of "the fundamental policy against federal interference with state criminal prosecutions." *Younger* v. *Harris*, 401 U.S. 37, 46 (1971). Similarly, construing the Code to permit the discharge of federal criminal restitution orders would undercut well-established federal sentencing policy. In the Victim and Witness Protection Act of 1982, Pub. L. No. 97-291, § 5, 96 Stat. 1253-1255, and various provisions of the Sentencing Reform Act, 18 U.S.C. 3553, 3663, 3664, Congress specifically conferred on restitution the high priority in the federal system that it has long enjoyed in other criminal justice systems. Federal judges are now required to consider restitution whenever they sentence a defendant, and to provide their reasons if they decide not to impose that sanction. In our view, the Bankruptcy Code should not be interpreted to permit criminal defendants to discharge penalties that Congress has expressly decided are necessary to vindicate the punitive, deterrent, and rehabilitative purposes of federal criminal law.

ARGUMENT

In *Kelly* v. *Robinson, supra,* the Court outlined the principles of statutory interpretation that should guide the resolution of this case. As this Court acknowledged, "the Code's definition of 'debt' is broadly drafted, and * * * the legislative history, as well as the Code's various priority and dischargeability provisions, supports a broad reading of the definition." 479 U.S. at 50 n.12. However, the Court observed that "[c]ourts traditionally have been reluctant to interpret federal bankruptcy statutes to remit state criminal judgments," even when that might have been the "most natural construction" of those provisions." *Id.* at 44. The Court added that "nothing in the legislative

history * * * compels the conclusion that Congress intended to change the state of the law with respect to criminal judgments." *Id.* at 50 n.12.

Thus, as in *Kelly,* it is necessary to "look to the provisions of the whole law" and to consider the statutory text "in light of the history of bankruptcy court deference to criminal judgments and in light of the interests of the States in unfettered administration of their criminal justice systems." 479 U.S. at 43-44. Moreover, as in *Kelly,* this case calls for application of a principle of statutory construction that the Court has followed "with particular care" in the bankruptcy context—the rule that "if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific." *Id.* at 47 (quoting *Midlantic National Bank* v. *New Jersey Dep't of Environmental Protection,* 474 U.S. 494, 501 (1986)). See *United States* v. *Ron Pair Enterprises, Inc.,* 109 S. Ct. 1026, 1031-1033 (1989).

These principles require the step that the Court found it unnecessary to take in *Kelly* v. *Robinson.* From the perspective of "the provisions of the whole law," accepting respondents' far-reaching interpretation of "claim" and "debt" would create severe anomalies; in contrast, the interpretation that we urge (and that Judge Hutchinson embraced in dissent below) would give the Code coherence and preserve well-established limitations on the powers of bankruptcy courts. Those limitations are not only of historical significance; in addition, they serve to avoid interference with state criminal proceedings and to safeguard important federal policies to which Congress has given additional emphasis in recent sentencing legislation.

A. When Viewed as a Whole, the Bankruptcy Code Compels the Conclusion that Criminal Penalties Are Not Debts

The focus of this case is on the dischargeability of criminal sanctions. However, the definitions of "debt,"

"claim," and "creditor" are integral to the application of the entire Code, and thus a proper interpretation of "debt" should take account of its effect on the statute as a whole. As we show below, our interpretation (excluding criminal monetary penalties from the "debts" administered under the Code) is consistent with a number of the Code's fundamental features—the scope of the automatic stay, the trustee's power to avoid preferential transfers, and the Code's scheme of priorities, as well as the discharge provisions that the Court examined in *Kelly*. By contrast, respondents' interpretation leads to anomalous and contradictory results.

1. *The Automatic Stay.*—Upon the filing of a bankruptcy petition, Section 362(a) of the Code, 11 U.S.C. 362(a), provides for a very broad stay of proceedings against the debtor and his property. This stay prohibits, among other things, the commencement or continuation of any action or proceeding against the debtor, the enforcement of any judgment against the debtor or his property, any efforts to take possession of the debtor's property, the creation, perfection, or enforcement of any liens against the debtor's property, and "any act to collect, assess, or recover a claim against the debtor that arose" before the bankruptcy petition was filed. 11 U.S.C. 362(a)(1)-(6). As the Senate Report accompanying the Code explained (S. Rep. No. 989, 95th Cong., 2d Sess. 54-55 (1978) [hereinafter *Senate Report*]):

> The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy.

Significantly, however, Congress specifically provided that debtors are not to be excused from any criminal proceedings. Section 362(b)(1) carves out an exception to the automatic stay for "the commencement or continuation of a criminal action or proceeding against the debtor."[4] This exception extends to all categories of proceedings enumerated in Section 362(a). This provision thus allows federal and state governments not only to prosecute a debtor, but to pursue all available means of collecting monetary penalties, including restitution, imposed as part of a criminal sentence.[5]

In this respect, the exception to the automatic stay for criminal proceedings is broader than the exceptions for civil proceedings through which federal and state governments may exercise their police and regulatory powers. Most notably, those exceptions do not allow collection of money judgments through a variety of means—enumerated in Section 362(a)(2)-(6)—that are permitted in the criminal context. See 11 U.S.C. 362(b)(4)-(5). The Senate

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[4] Cf. *Ohio* v. *Kovacs*, 469 U.S. 274, 284 (1985) (noting availability of criminal penalties against debtor in bankruptcy).

[5] *134 Baker St., Inc.* v. *Georgia*, 47 Bankr. 379 (N.D. Ga. 1984); *United States* v. *Troxler Hosiery Co., Inc.*, 41 Bankr. 457 (D.N.C. 1984) (fine for criminal contempt), aff'd, 796 F.2d 723 (4th Cir. 1986), cert. denied, 480 U.S. 930 (1987); *In re Kohr*, 82 Bankr. 706 (Bankr. M.D. Pa. 1988); *In re Mead*, 41 Bankr. 838, 841 (Bankr. D. Conn. 1984) (criminal restitution); *In re Pellegrino*, 42 Bankr. 129, 135-136 (Bankr. D. Conn. 1984) (same); *In re Vik*, 45 Bankr. 64, 65-66 (Bankr. N.D. Iowa 1984) (same). Contra, *In re Landstrom Distributors, Inc.*, 55 Bankr. 390 (Bankr. C.D. Cal. 1985); *In re Blair*, 62 Bankr. 650 (Bankr. N.D. Ala. 1986).

As the *Troxler* court stressed, proceedings to collect criminal penalties must be considered part of the "continuation" of a criminal proceeding, since "[a] criminal sentence without accompanying authority to ensure service by the defendant as ordered would be meaningless." 41 Bankr. at 460.

Report explained the basis for the broad exception for criminal proceedings as follows (*Senate Report* 51):

> The bankruptcy laws are not a haven for criminal offenders, but are designed to give relief from financial overextension. Thus, criminal actions and proceedings may proceed in spite of bankruptcy.

Accord, H.R. Rep. No. 595, 95th Cong., 1st Sess. 342 (1977) [hereinafter *House Report*]; 2 *Collier on Bankruptcy* ¶ 362.05[1] (15th ed. 1989).

The scope of the exception to the automatic stay and its underlying rationale provide strong support for an interpretation of the Code that would remove criminal penalties from the bankruptcy system. As a number of bankruptcy court decisions have noted (see note 5, *supra*), it would be inherently contradictory for the Code to allow enforcement of criminal penalties to go forward without interference from bankruptcy proceedings while at the same time requiring those penalties to be administered along with civil debts in the very same proceedings.

2. *Preferences.*—A "prime bankruptcy policy" is "equality of distribution among creditors of the debtor." *House Report* 178; see 4 *Collier on Bankruptcy* ¶ 547.01, at 547-11 & n.18 (15th ed. 1989). In keeping with that policy, the trustee in bankruptcy is generally empowered to avoid any preferential transfer of an insolvent debtor's property occurring within 90 days of the filing of a petition that is (11 U.S.C. 547(b) (emphasis added)):

> (1) to or for the benefit of a *creditor*; [and]
>
> (2) for or on account of an antecedent *debt* owed by the debtor before such transfer was made * * *.

If a criminal fine or restitution order is a "debt" and the governmental authority responsible for collection is a "creditor," this provision would seem to require States and the federal government to refund fines collected from in-

solvent debtors within the 90 days prior to the filing of their bankruptcy petitions. One bankruptcy court has so held. *In re Hackney*, 83 Bankr. 20 (Bankr. N.D. Cal. 1988) (payment in compliance with criminal restitution order was preference avoidable by bankruptcy trustee).

However, in view of the exception to the automatic stay discussed above, it is clear that Congress could not have intended that payments against criminal fines would be preferences. Section 362(b)(1) expressly authorizes state and federal authorities to collect criminal monetary penalties even *after* a bankruptcy petition has been filed. It is singularly unlikely that the Legislature also intended that authorities who collect a fine or restitution on the eve of a defendant's bankruptcy must return the payment. This absurd result, which does not exist if criminal penalties do not constitute "debts," should not be attributed to Congress.

3. *Priorities.*—Section 726 of the Code establishes the order in which categories of "claims" are satisfied from the debtor's estate in a Chapter 7 bankruptcy. It also provides the framework against which Chapter 13 plans are evaluated; under Section 1325(a)(4), a plan must provide each unsecured creditor with value, as of the effective date of the plan, no less than the creditor would receive under Chapter 7. Section 726(a)(4) assigns a very low priority to any pre-petition claim, "whether secured or unsecured," for (11 U.S.C. 726(a)(4))

> any fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages, * * * to the extent that such fine, penalty, forfeiture, or damages are not compensation for actual pecuniary loss suffered by the holder of such claim.

The only claims against a debtor with lower priority are those for post-petition interest; claims for "fines, penalties, and forfeitures" are beneath even untimely unsecured claims, see 11 U.S.C. 726(a)(3). In fact, the

Code subordinates even *secured* claims for these fines, penalties, and forfeitures, and it empowers the bankruptcy trustee to avoid any lien that corresponds to a claim of that kind, 11 U.S.C. 724(a) (trustee may avoid liens securing "a claim of a kind specified in Section 726(a)(4)"). If criminal penalties are "debts", that is the priority they would appear to receive under the Code.

That understanding of the Code's application to criminal sanctions is no more plausible in this context than in the context of preferences. At the outset, it is doubtful that Congress would have given state and federal criminal judgments no greater priority than this. Moreover, the exception to the automatic stay for criminal proceedings specifically allows "any act to create, perfect, or enforce any lien against property of the [debtor's] estate" and "any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of" the bankruptcy proceeding. 11 U.S.C. 362(a)(4)-(5).[6] Under respondents' view, therefore, Congress must be deemed to have given a trustee the power in Chapter 7 proceedings, under Section 724(a), to avoid the very liens that the exception to the automatic stay permits state and federal governments to create, perfect, and enforce while bankruptcy proceedings are pending. Once again, excluding criminal penalties from the definition of "debt" eliminates the problem altogether.

That interpretation also mitigates the incongruity of the low priority given to "any fine, penalty, or forfeiture * * *

[6] Under 18 U.S.C. 3613(a), which is incorporated as to restitution in 18 U.S.C. 3663(h), a fine creates a lien "in favor of the United States upon all property belonging to the person fined." That lien—and the underlying liability—are protected from discharge in bankruptcy as to fines. 18 U.S.C. 3613(f). The applicability of Section 3613(f) to federal restitution obligations, and liens securing them, has yet to be settled.

that [is] not compensation for pecuniary loss" under Section 726. If viewed in isolation, that category might be read to refer to criminal fines and restitution orders. However, Section 726 does not purport to confer the status of a "debt" on any obligation. Further, in view of the results that flow from that construction, it is more plausible to conclude that Congress intended that this section would apply only to *civil* fines, penalties and forfeitures—and not to *criminal* sentences.[7] That interpretation would also be consistent with the preferred position that Section 362 gives criminal, as opposed to civil, enforcement proceedings and the fact that fines, penalties, and forfeitures are grouped in Section 726 with "multiple, exemplary, and punitive damages," remedies that are civil in nature.

4. *Dischargeability.*—The court of appeals placed heavy reliance on Section 523(a)(7), which exempts from certain discharges a category of fines, penalties, and forfeitures that is nearly the same as the one encompassed by Section 726(a)(4). In the court of appeals' view, Section 523(a)(7) indicates that Congress included all civil and criminal fines and penalties within the Code's definition of "debt" and made a considered decision to discharge criminal penalties under Chapter 7, but not under Chapter 13. For several reasons, that understanding of Section 523(a)(7)'s place in the statutory scheme is untenable.

First, in view of the similarity between the language of this Section and that of Section 726(a)(4), the two provisions should be read *in pari materia.* As demonstrated above, it is implausible to view Section 726(a)(4) as ap-

[7] The reported cases provide examples of those civil sanctions. *In re Carracino,* 53 Bankr. 513 (Bankr. D.N.J. 1985) (civil fines for environmental violations); *In re Daugherty,* 25 Bankr. 158 (Bankr. E.D. Tenn. 1982) (civil penalty for strip mining violation); *In re Tauscher,* 7 Bankr. 918 (Bankr. E.D. Wis. 1981) (civil money penalties for child labor law violations).

plicable to criminal penalties; it is fair to assume that Section 523(a)(7) has no broader scope.

Second, in view of its place in the statute, Section 523(a)(7) does not suggest that any type of obligation is a "debt." Rather, it provides that if an obligation is a debt—a question determined by reference to other sources—then the obligation is nondischargeable "to the extent that" it is a fine, penalty, or forfeiture of the type described.[8] To read Section 523(a)(7) as an indicator of the scope of the definition of "debt" puts the cart before the horse; the definition of "debt" determines the obligations to which Section 523(a)(7) applies, not vice versa.

Finally, understanding Section 523(a)(7) to include criminal monetary penalties, the consequence of considering such penalties to be "debts," creates the same kinds of contradictions that follow that interpretation throughout the Code. As the court of appeals noted, if a criminal fine or restitution order is a "debt," the language of Sections 523(a)(7) and 1328(a) would result in its being discharged in Chapter 7, but not Chapter 13. On its face, the court of appeals' understanding of this result—as an incentive designed to promote use of Chapter 13—is an improbable one. The only debtors who could be influenced by that particular aspect of a discharge under Chapter 13 would be individuals convicted of crimes who had not paid their fines or restitution orders. It is unlikely that Congress

[8] In *Kelly* v. *Robinson*, 479 U.S. at 51, the Court did state that Section 523(a)(7) "codifies the judicially created exception to discharge for fines." However, in view of the "serious doubts" that the Court expressed on the question whether fines were "debts," 479 U.S. at 50, *Kelly* can fairly be read to hold only that to the extent such fines are debts, they would be excluded from discharge under Section 523(a)(7). In view of the "serious doubts" that *Kelly* expressed with respect to respondents' interpretation, that decision obviously cannot be read to have adopted respondents' position.

would have viewed the goal of providing relief to that group as outweighing the state and federal interest in the enforcement of criminal law. Moreover, Congress could not have contemplated that Chapter 13 debtors would be likely to pay a significantly greater proportion of their criminal fines or restitution than those in Chapter 7.[9]

Any doubt on whether Congress intended Section 523(a)(7) to control the dischargeability of criminal penalties is dispelled by an examination of Chapter 11. Under Chapter 11, corporate debtors that reorganize, but not individual debtors, are discharged from the debts described in Section 523(a)(7). 11 U.S.C. 1141(d)(1)(A) and (2). Thus, if the court of appeals' understanding of Section 523(a)(7) is correct, Congress must be deemed to have authorized corporations, but not individuals, to obtain discharges of criminal monetary penalties in Chapter 11 proceedings. See *In re Wisconsin Barge Lines, Inc.*, 91 Bankr. 65, 67-68 (Bankr. E.D. Mo. 1988) (fine imposed on corporation for criminal violations of environmental statutes is a debt dischargeable in a Chapter 11 reorganization proceeding). Since corporations cannot be imprisoned, allowing them to discharge their monetary penalties in reorganization proceedings would effectively undercut the only sanctions that may be imposed for corporate violations of criminal law.

In short, Section 523(a)(7) provides no support for the view that "debts" include criminal penalties. To the con-

[9] As long as no creditor receives less than he would in a Chapter 7 proceeding, 11 U.S.C. 1325(a)(4), there is no requirement that a Chapter 13 plan provide for any level of payments to unsecured creditors. *Deans* v. *O'Donnell*, 692 F.2d 968 (4th Cir. 1982). Very often, the payments to unsecured creditors are minimal. See *In re Kohr*, 82 Bankr. at 712 ("Most [Chapter 13 plans] provide very small payments to unsecured creditors. I have approved plans with no payments going to unsecured creditors.").

trary, in view of that Section's differential application to various forms of bankruptcy, such an interpretation would ascribe to Congress a perverse accommodation between the interests of the bankruptcy system and the interests of state and federal governments in the effective enforcement of criminal law against corporate and individual defendants.

5. *Participation in bankruptcy proceedings by governmental units and victims.* – As the court of appeals noted, if criminal penalties are not "debts," then governmental authorities are not "creditors" with "claims" that may be presented in a bankruptcy proceeding. The court of appeals described that result as "anomalous" and "incredible." Pet. App. 23a, 26a. That assertion overlooks the facts that the automatic stay does not forbid efforts to collect criminal penalties, and that States and the federal government have substantial power to collect criminal penalties outside the bankruptcy system. See 18 U.S.C. 3613, 3663(h). Congress could plausibly have determined that it was unnecessary to extend to these governmental entities the often questionable benefits – and the significant burdens – of participation as "creditors" in bankruptcy proceedings.

* * * * *

This case presents a choice between two fundamentally different views of the relation between the federal bankruptcy system and the criminal justice systems of the States and the federal government. Respondents' view is a contradictory and anomalous one. It posits that, although Congress structured the automatic stay to avoid creating a "haven" for criminals, the Article I Branch nevertheless intended (i) that bankruptcy trustees could require refunds of criminal fines that had been paid on the eve of bankruptcy; (ii) that when the debtor's estate had been

assembled, States and the federal government would be paid the penalties imposed by courts to vindicate the purposes of the criminal law only after all other unsecured creditors had been paid in full, including even unsecured creditors who had not even filed timely claims; and (iii) that, as among corporations and individuals convicted of crimes, individuals in Chapter 13 and corporations in Chapter 11 were to be given more bankruptcy relief from their sentences than similarly situated individuals in Chapters 7 and 11.

By contrast, excluding criminal sentences from the definition of "debt" would result in a coherent accommodation between bankruptcy and criminal law. Under that scheme, governments would continue to employ the traditional remedies that Congress exempted from the automatic stay to collect criminal monetary penalties, and no debtor could use bankruptcy to avoid compliance with a criminal sentence that a court has determined to be appropriate to vindicate the purposes of the criminal law. The "provisions of the whole law," *Kelly* v. *Robinson*, 479 U.S. at 43, fully justify exclusion of criminal penalties from the "debts" administered in the bankruptcy system.

B. Excluding Criminal Penalties from the Definition of "Debt" Would Be Entirely Consistent with Traditional Bankruptcy Principles

The history of the bankruptcy system also lends support to excluding criminal penalties from the definition of "debt." As this Court found in *Kelly* v. *Robinson*, 479 U.S. at 46, courts applying the Bankruptcy Act of 1898 recognized "an established judicial exception to discharge for criminal sentences, including restitution orders."[10] The

[10] See, e.g., *In re Moore*, 111 F. 145 (W.D. Ky. 1901); See also *Zwick* v. *Freeman*, 373 F.2d 110, 116 (2d Cir.), cert. denied, 389 U.S. 835 (1967).

results of the interpretation that we advocate would also conform to bankruptcy law's traditional approach to criminal penalties in a number of other respects.

1. Section 11(a) of the 1898 Act, the predecessor of Section 362 of the Code, did not bar the commencement or continuation of criminal proceedings to collect fines and other criminal monetary relief. Section 11 stayed only each suit "which is founded upon a claim from which a discharge would be a release." Since criminal penalties were not dischargeable, *Kelly* v. *Robinson,* 479 U.S. at 44-46; 1A *Collier on Bankruptcy* ¶ 17.05, at 1587, ¶ 17.13, at 1609-1610 & n.10 (14th ed. 1978), Section 11 did not restrain the enforcement of criminal penalties. *In re Koronosky,* 170 F. 719 (2d Cir. 1909) (enforcement of criminal contempt sanction not stayed by bankruptcy filing); *In re Thomashefsky,* 51 F.2d 1040 (2d Cir. 1931). Allowing governments to enforce criminal penalties outside the bankruptcy system would be consistent with this aspect of pre-Code law.

2. Similarly, Section 60 of the Act, which governed preferences, applied to transfers to "a creditor for or on account of an antecedent debt." Under Section 1(11) of the Act, the term "creditor" included "anyone who owns a debt, demand, or claim provable in bankruptcy." It followed that "a preference [could] be given only where the person benefited [held] a provable claim." 3 *Collier on Bankruptcy* ¶ 60.17, at 834 (14th ed. 1977). The same established line of authority on which the Court relied in *Kelly* v. *Robinson* compels the conclusion that a fine or other criminal penalty was not a debt that could be the subject of a preferential transfer under the 1898 Act.

3. Because criminal fines and restitution orders were not "allowable" debts, governmental authorities to which

payments were due did not participate in a bankrupt's distribution under the 1898 Act. See *United States* v. *Birmingham Trust & Savings Co.,* 258 F. 562, 564 (5th Cir.), cert. denied, 251 U.S. 550 (1919). In the light of that history, it would be neither "anomalous" nor "incredible" (Pet. App. 23a, 26a) to construe the present statute to require the same result.[11]

In short, the consequences that would accompany construing the term "debt" to exclude monetary criminal penalties would be consistent with the treatment that those obligations received under the 1898 Act. The coherent scheme that would result from that interpretation of the Code, see p. 21, *supra,* would be substantially the same scheme that prevailed under pre-Code law.

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[11] The Code did make some changes in the area of civil penalties owed to the government. Except to the extent of any pecuniary loss suffered by a governmental entity, civil penalties were disallowed completely by Section 57j of the 1898 Act. See *Kelly* v. *Robinson,* 479 U.S. at 44; 3 *Collier on Bankruptcy* ¶ 57.22 (14th ed. 1978). Moreover, most courts held that those civil penalties were also not dischargeable, notwithstanding the Bankruptcy Act's silence on that issue. *In re Abramson,* 210 F. 878 (2d Cir. 1914); *Sherwood* v. *United States,* 228 F. Supp. 247 (E.D.N.Y. 1964); 3A *Collier on Bankruptcy* ¶ 63.12 (14th ed. 1978). See *Simonson* v. *Granquist,* 369 U.S. 38 (1962). As is noted above (pp. 15-20, *supra*), Sections 726(a)(4) and 523(a)(7) modify those results somewhat. They provide, respectively, that civil penalties are a low-priority unsecured claim in a bankruptcy proceeding and that they are protected from discharge only in Chapter 7. It is not surprising—or inconsistent with the preservation of the old regime for criminal penalties—that Congress adopted a somewhat different approach to civil penalties than it did to criminal penalties. As we have noted above, the Code draws a comparable distinction between civil and criminal enforcement proceedings for purposes of the automatic stay. And, even under the 1898 Act, there had been disagreement over the proper handling of civil claims. *Kelly* v. *Robinson,* 479 U.S. at 45 n.6. See *Parker* v. *United States,* 153 F.2d 66 (1st Cir. 1946) (civil contempt fine is dischargeable, notwithstanding contrary rule for criminal contempt).

C. Respondents' Interpretation of the Code Would Violate Principles of Federalism and Congressionally Mandated Federal Sentencing Policy

1. In *Kelly* v. *Robinson,* 479 U.S. at 47, the Court noted that a proper interpretation of the Code in this area "must reflect the basis for [the] judicial exception [to dischargeability], a deep conviction that federal bankruptcy courts should not invalidate the results of state criminal proceedings." Any different approach would contradict the "fundamental policy against federal interference with state criminal proceedings." *Ibid.* (quoting *Younger* v. *Harris,* 401 U.S. at 46).

Experience with the Code demonstrates that the potential for federal-state interference is not limited to Chapter 7 bankruptcies of the type at issue in *Kelly,* or even to disputes over dischargeability. Friction between state authorities and bankruptcy courts inevitably accompanies respondents' interpretation of the statute. Bankruptcy courts that have concluded that criminal penalties are "debts" have enjoined state courts from enforcing fines, *In re Heincy,* 78 Bankr. 246 (Bankr. 9th Cir.), rev'd on other grounds, 858 F.2d 548 (9th Cir. 1988); *In re Cancel,* 85 Bankr. 677 (N.D.N.Y. 1988); have issued injunctions running to state courts and prosecutors to prevent revocation of probation conditioned on the payment of restitution, *In re Cullens,* 77 Bankr. 825 (Bankr. D. Colo. 1987); *In re Brown,* 39 Bankr. 820, 826-830 (Bankr. M.D. Tenn. 1984); and have determined that state authorities must turn over to the bankruptcy trustee money that had been paid in partial satisfaction of a criminal fine, *In re Hackney, supra.* See also *In re Kohr, supra* (debtors sought to have state district justice held in contempt in bankruptcy court for his issuance of an arrest warrant upon debtors' failure to pay a criminal fine).

These cases demonstrate that any attempt to administer criminal sentences together with the fundamentally different civil obligations for which the bankruptcy system is designed is destined to generate conflicts between bankruptcy judges and state courts. The concern for federalism that the Court emphasized in *Kelly* v. *Robinson, supra,* strongly supports an interpretation of the Code that will remove criminal sentences from the bankruptcy system altogether.

2. Established federal sentencing policy provides additional support for the view that restitution orders imposed as part of criminal sentences are not "debts" subject to administration within the federal bankruptcy system. See *Midlantic National Bank* v. *New Jersey Dep't of Environmental Protection,* 474 U.S. at 505; *United States* v. *Ron Pair Enterprises, Inc.,* 109 S. Ct. at 1032. Under the Sentencing Reform Act, 18 U.S.C. 3553(a)(7), district courts are required to consider, among other things, "the need to provide restitution to any victims of the offense." There is a presumption in favor of restitution. "If the court does not order restitution, or orders only partial restitution, the court shall include in [the statement of its application of the Sentencing Guidelines to the defendant] the reason therefor." 18 U.S.C. 3553(c). Courts may not impose a fine that would impair the defendant's ability to make restitution, 18 U.S.C. 3572(b); indeed, under the Sentencing Guidelines, any sentence that provides for both a fine and restitution must provide that the restitution will be paid first, United States Sentencing Commission Guidelines Manual § 5E4.1.

These provisions build upon Section 5 of the Victim and Witness Protection Act of 1982, Pub. L. No. 97-291, 96 Stat. 1253-1255. The Senate Committee Report accompanying the legislation made clear that its purpose was to give restitution orders a "priority status" in the federal

criminal justice system. S. Rep. No. 532, 97th Cong., 2d Sess. 30 (1982). The Report explained (*ibid.*):

> The principle of restitution is an integral part of virtually every formal system of criminal justice, of every culture and every time. It holds that, whatever else the sanctioning power of society does to punish its wrongdoers, it should also insure that the wrongdoer is required to the degree possible to restore the victim to his or her prior state of well-being.

Congress reasserted its commitment to criminal restitution in the legislation it enacted to address the crisis facing the Nation's thrift institutions. Section 966 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183, authorized an additional $65,000,000 for the Justice Department for each of fiscal years 1990-1992 to pay for investigations and prosecutions for crimes committed against financial institutions. Many members of Congress expressed the hope that these prosecutions would result in criminal sentences requiring individuals who had siphoned funds from insured institutions to make good the losses they had imposed on federal insurers and ultimately the taxpayer.[12]

[12] See 135 Cong. Rec. H2559 (daily ed. June 14, 1989) (remarks of Rep. Wylie) ("[W]e put $75 million in this bill to give to the Justice Department so it can pursue the crooks who stole from the FSLIC fund to line their own pockets. The Justice Department must be encouraged to be vigilant in pursuit of the criminals and work to gain restitution of some of the property fraudulently invested in with depositors' money."); 135 Cong. Rec. S3994 (daily ed. Apr. 17, 1989) (remarks of Sen. Bond) (increased funding will allow the Justice Department "to go out after those individuals who defrauded the system and who looted the system, to track them down and bring them to justice and recover everything we can financially."); 135 Cong. Rec. S4001 (April 17, 1989) (remarks of Senator Bond) ("We cannot, in good conscience, accept the burdens that this bill puts on the taxpayer without actively pursuing every crook who stole from FSLIC with maximum criminal penalties and maximum recovery of ill-gotten gain.").

Significantly, Congress took account of the possibility that restitution could unfairly burden a defendant and specifically addressed that issue in its sentencing statutes. Under 18 U.S.C. 3664, a sentencing court is required to consider "the financial resources of the defendant" and "the financial needs and earning ability of the defendant and the defendant's dependents" when it fixes the amount of an award of restitution. Those awards thus take account of the defendant's ability to pay, and bankruptcy protection is unnecessary to avoid injustice.

Construing the Bankruptcy Code to permit discharge of criminal restitution orders would undercut the accommodations that district courts are required to draw between the needs of victims, the interest of the criminal justice system in deterrence, punishment, and rehabilitation, and the defendant's financial circumstances. As many courts of appeals have agreed, it is entirely consistent with the factors that Congress has required sentencing courts to consider for a court to impose a substantial restitution order on a defendant who lacks assets or is in bankruptcy at the time of sentencing.[13] Particularly in the case of

[13] *United States* v. *Ryan*, 874 F.2d 1052 (5th Cir. 1989); *United States* v. *Sunrhodes*, 831 F.2d 1537, 1546 (10th Cir. 1987); *United States* v. *Parther*, 823 F.2d 965, 970 (6th Cir. 1987); *United States* v. *Atkinson*, 788 F.2d 900, 904 (2d Cir. 1986); *United States* v. *Fountain*, 768 F.2d 790, 802-803 (7th Cir. 1985), modified on other grounds, 777 F.2d 345, cert. denied, 475 U.S. 1124 (1986); *United States* v. *Keith*, 754 F.2d 1388, 1393 (9th Cir.), cert. denied, 474 U.S. 829 (1985).

Moreover, a court may award restitution for a criminal offense even if the civil obligation arising from that crime has been discharged. *United States* v. *Alexander*, 743 F.2d 472, 480 (7th Cir. 1984) ("The 'fresh start' envisioned by the imposition of probation conditions [providing for restitution] is entirely different from the one resulting from discharge in bankruptcy."); *Barnette* v. *Evans*, 673 F.2d 1250 (11th Cir. 1982); *United States* v. *Carson*, 669 F.2d 216 (5th Cir. 1982).

white-collar criminals, such defendants may have substantial future earnings prospects. A restitution award may also be appropriate to deter other individuals from committing similar crimes. Cf. *Kelly* v. *Robinson*, 479 U.S. at 49 n.10 ("the direct relation between the harm and the punishment gives restitution a more precise deterrent effect than a traditional fine"). If a defendant were eligible for Chapter 13, respondents' interpretation of the Code could enable him to discharge the restitution order. The Bankruptcy Code should not be construed to invalidate criminal sentences that Congress has found are necessary to vindicate the purposes of the criminal law.[14]

[14] As was noted above, Congress has provided expressly that federal criminal fines are exempt from discharge under the Bankruptcy Code. 18 U.S.C. 3613(f). The Senate has also passed a bill that, if enacted, would affect the dischargeability of state and federal criminal monetary penalties, among others. On October 5, 1989, and again on November 3, 1989, the Senate passed S. 84, 101st Cong., 1st Sess., a bill entitled the Federal Debt Collection Procedures Act of 1989. In addition to creating a comprehensive scheme of federal law for debts owed to the federal government, the bill would add a subsection to Section 523(a) of the Code that would exempt from discharge any debt (135 Cong. Rec. S13448 (daily ed. Oct. 15, 1989))

> (11) to the extent that such debt arises from a violation by the debtor of a civil or criminal law enforceable by an action by a governmental unit to recover restitution, damages, civil penalties, attorneys fees, costs, or any other relief, or to the extent that such debt arises from an agreed judgment or other agreement by the debtor to pay money or transfer property in settlement of such an action by a governmental unit.

Section 1328 of the Bankruptcy Code would also be amended to make this exception applicable to discharges under Chapter 13. *Ibid.* A somewhat similar bill passed the Senate last year, but was not enacted. S. 1961, 100th Cong., 2d Sess. (1988).

In our view, enactment of this legislation would not eliminate the need for the Court's guidance on whether a criminal penalty creates a "debt." As reflected above, the consequences of that interpretation are felt throughout the Code.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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